

EXFO Inc.
Condensed Unaudited Interim Consolidated Balance Sheets

(in thousands of US dollars)

	As at May 31, 2013	As at August 31, 2012
Assets		
Current assets		
Cash	\$ 49,858	\$ 58,868
Short-term investments	4,939	8,236
Accounts receivable		
Trade	46,794	37,643
Other	2,802	4,283
Income taxes and tax credits recoverable	5,915	9,024
Inventories	38,399	41,212
Prepaid expenses	4,465	3,800
	153,172	163,066
Tax credits recoverable	41,894	38,397
Property, plant and equipment	45,775	49,848
Intangible assets	8,664	14,132
Goodwill	27,740	29,160
Deferred income taxes	10,867	12,080
	\$ 288,112	\$ 306,683
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	\$ 30,255	\$ 32,392
Provisions	902	952
Income taxes payable	1,502	917
Current portion of long-term debt	580	565
Deferred revenue	10,869	10,583
	44,108	45,409
Deferred revenue	4,245	4,997
Long-term debt	–	282
Other liabilities	357	609
Deferred income taxes	2,452	2,105
	51,162	53,402
Shareholders' equity		
Share capital (note 4)	110,510	110,965
Contributed surplus	16,872	17,298
Retained earnings	109,050	111,511
Accumulated other comprehensive income	518	13,507
	236,950	253,281
	\$ 288,112	\$ 306,683

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

EXFO Inc.

Condensed Unaudited Interim Consolidated Statements of Earnings

(in thousands of US dollars, except share and per share data)

	Three months ended May 31, 2013	Nine months ended May 31, 2013	Three months ended May 31, 2012	Nine months ended May 31, 2012
Sales	\$ 58,865	\$ 181,262	\$ 59,505	\$ 192,810
Cost of sales ⁽¹⁾ (note 5)	22,574	69,895	23,549	70,535
Selling and administrative (note 5)	22,002	67,366	23,625	71,919
Net research and development (note 5)	11,573	35,135	13,173	37,963
Depreciation of property, plant and equipment (note 5)	1,473	4,582	1,520	4,634
Amortization of intangible assets (note 5)	1,586	5,470	1,993	5,888
Changes in fair value of cash contingent consideration	-	-	-	(311)
Earnings (loss) from operations	<u>(343)</u>	<u>(1,186)</u>	<u>(4,355)</u>	<u>2,182</u>
Interest income	68	76	85	68
Foreign exchange gain	314	2,770	1,090	1,283
Earnings (loss) before income taxes	<u>39</u>	<u>1,660</u>	<u>(3,180)</u>	<u>3,533</u>
Income taxes (note 6)	<u>901</u>	<u>4,121</u>	<u>540</u>	<u>3,412</u>
Net earnings (loss) for the period	<u><u>\$ (862)</u></u>	<u><u>\$ (2,461)</u></u>	<u><u>\$ (3,720)</u></u>	<u><u>\$ 121</u></u>
Basic and diluted net earnings (loss) per share	\$ (0.01)	\$ (0.04)	\$ (0.06)	\$ 0.00
Basic weighted average number of shares outstanding (000's)	60,377	60,386	60,537	60,440
Diluted weighted average number of shares outstanding (000's) (note 7)	60,377	60,386	60,537	61,694

(1) The cost of sales is exclusive of depreciation and amortization, shown separately.

EXFO Inc.

Condensed Unaudited Interim Consolidated Statements of Comprehensive Loss

(in thousands of US dollars)

	Three months ended <u>May 31, 2013</u>	Nine months ended <u>May 31, 2013</u>	Three months ended <u>May 31, 2012</u>	Nine months ended <u>May 31, 2012</u>
Net earnings (loss) for the period	\$ (862)	\$ (2,461)	\$ (3,720)	\$ 121
Other comprehensive income (loss), net of income taxes				
Items that will not be reclassified subsequently to net earnings				
Foreign currency translation adjustment	(1,252)	(12,144)	(12,307)	(17,934)
Items that may be reclassified subsequently to net earnings				
Unrealized gains/losses on forward exchange contracts	(112)	(874)	(1,066)	(922)
Reclassification of realized gains/losses on forward exchange contracts in net earnings (loss)	48	(281)	(285)	(1,265)
Deferred income tax effect of gains/losses on forward exchange contracts	17	310	362	594
Other comprehensive loss	<u>(1,299)</u>	<u>(12,989)</u>	<u>(13,296)</u>	<u>(19,527)</u>
Comprehensive loss for the period	<u>\$ (2,161)</u>	<u>\$ (15,450)</u>	<u>\$ (17,016)</u>	<u>\$ (19,406)</u>

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

EXFO Inc.

Condensed Unaudited Interim Consolidated Statements of Changes in Shareholders' Equity

(in thousands of US dollars)

	Nine months ended May 31, 2012				
	Share capital	Contributed surplus	Retained earnings	Accumulated other comprehensive income	Total shareholders' equity
Balance as at September 1, 2011	\$ 110,341	\$ 18,017	\$ 115,104	\$ 21,049	\$ 264,511
Exercise of stock options (note 4)	118	–	–	–	118
Redemption of share capital (note 4)	(404)	(222)	–	–	(626)
Reclassification of stock-based compensation costs (note 4)	1,835	(1,835)	–	–	–
Stock-based compensation costs	–	1,362	–	–	1,362
Net earnings for the period	–	–	121	–	121
Other comprehensive loss					
Foreign currency translation adjustment	–	–	–	(17,934)	(17,934)
Changes in unrealized gains on forward exchange contracts, net of deferred income taxes of \$594	–	–	–	(1,593)	(1,593)
Total comprehensive income (loss) for the period	–	–	121	(19,527)	(19,406)
Balance as at May 31, 2012	<u>\$ 111,890</u>	<u>\$ 17,322</u>	<u>\$ 115,225</u>	<u>\$ 1,522</u>	<u>\$ 245,959</u>

	Nine months ended May 31, 2013				
	Share capital	Contributed surplus	Retained earnings	Accumulated other comprehensive income	Total shareholders' equity
Balance as at September 1, 2012	\$ 110,965	\$ 17,298	\$ 111,511	\$ 13,507	\$ 253,281
Exercise of stock options (note 4)	87	–	–	–	87
Redemption of share capital (note 4)	(1,892)	(409)	–	–	(2,301)
Reclassification of stock-based compensation costs (note 4)	1,350	(1,350)	–	–	–
Stock-based compensation costs	–	1,333	–	–	1,333
Net loss for the period	–	–	(2,461)	–	(2,461)
Other comprehensive loss					
Foreign currency translation adjustment	–	–	–	(12,144)	(12,144)
Changes in unrealized gains/losses on forward exchange contracts, net of deferred income taxes of \$310	–	–	–	(845)	(845)
Total comprehensive loss for the period	–	–	(2,461)	(12,989)	(15,450)
Balance as at May 31, 2013	<u>\$ 110,510</u>	<u>\$ 16,872</u>	<u>\$ 109,050</u>	<u>\$ 518</u>	<u>\$ 236,950</u>

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

EXFO Inc.

Condensed Unaudited Interim Consolidated Statements of Cash Flows

(in thousands of US dollars)

	Three months ended May 31, 2013	Nine months ended May 31, 2013	Three months ended May 31, 2012	Nine months ended May 31, 2012
Cash flows from operating activities				
Net earnings (loss) for the period	\$ (862)	\$ (2,461)	\$ (3,720)	\$ 121
Add (deduct) items not affecting cash				
Change in discount on short-term investments	1	–	–	43
Stock-based compensation costs	415	1,331	370	1,433
Depreciation and amortization	3,059	10,052	3,513	10,522
Changes in fair value of cash contingent consideration	–	–	–	(311)
Deferred revenue	1,661	241	2,629	1,976
Deferred income taxes	263	1,984	445	2,020
Change in foreign exchange gain/loss	(78)	(876)	(1,091)	(2,130)
	<u>4,459</u>	<u>10,271</u>	<u>2,146</u>	<u>13,674</u>
Change in non-cash operating items				
Accounts receivable	(4,569)	(10,657)	(2,339)	268
Income taxes and tax credits	985	(2,201)	(2,308)	(3,566)
Inventories	(262)	791	1,930	9,573
Prepaid expenses	(804)	(859)	(238)	(451)
Accounts payable, accrued liabilities and provisions	1,553	1,503	3,478	3,443
Other liabilities	(25)	(235)	163	11
	<u>1,337</u>	<u>(1,387)</u>	<u>2,832</u>	<u>22,952</u>
Cash flows from investing activities				
Additions to short-term investments	(9,934)	(44,703)	(24,170)	(91,968)
Proceeds from disposal and maturity of short-term investments	9,921	47,731	21,135	128,901
Additions to capital assets	(1,459)	(5,952)	(6,826)	(18,003)
	<u>(1,472)</u>	<u>(2,924)</u>	<u>(9,861)</u>	<u>18,930</u>
Cash flows from financing activities				
Bank loan	–	–	3	(782)
Repayment of long-term debt	–	(293)	–	(296)
Exercise of stock options	–	87	40	118
Redemption of share capital	(1,161)	(2,301)	–	(626)
	<u>(1,161)</u>	<u>(2,507)</u>	<u>43</u>	<u>(1,586)</u>
Effect of foreign exchange rate changes on cash				
	<u>(271)</u>	<u>(2,192)</u>	<u>(2,354)</u>	<u>(1,158)</u>
Change in cash	(1,567)	(9,010)	(9,340)	39,138
Cash – Beginning of the period	51,425	58,868	71,249	22,771
Cash – End of the period	<u>\$ 49,858</u>	<u>\$ 49,858</u>	<u>\$ 61,909</u>	<u>\$ 61,909</u>
Supplementary information				
Interest paid	\$ 2	\$ 28	\$ 3	\$ 61
Income taxes paid	\$ 118	\$ 1,055	\$ 367	\$ 1,357

As at May 31, 2012 and 2013, unpaid purchases of capital assets amounted to \$2,601 and \$279 respectively.

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

EXFO Inc.

Notes to Condensed Unaudited Interim Consolidated Financial Statements

(tabular amounts in thousands of US dollars, except share and per share data and as otherwise noted)

1 Nature of Activities and Incorporation

EXFO Inc. and its subsidiaries (together “EXFO” or the company) design, manufacture and market test and service assurance solutions for wireless and wireline network operators and equipment manufacturers in the global telecommunications industry. The company offers core-to-edge solutions to assess the performance and reliability of converged Internet protocol (IP) fixed and mobile networks.

EXFO is a company incorporated under the Canada Business Corporations Act and domiciled in Canada. The address of its headquarters is 400 Godin Avenue, Quebec, Province of Quebec, Canada, G1M 2K2.

These condensed interim consolidated financial statements were authorized for issue by the Board of Directors on June 26, 2013.

2 Basis of Presentation

These condensed interim consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS), as issued by the *International Accounting Standards Board* (IASB) applicable to the preparation of interim financial statements, including IAS 34, “*Interim Financial Reporting*”, and using the same accounting policies and methods used in the preparation of the company’s most recent annual consolidated financial statements. Consequently, these condensed interim consolidated financial statements should be read in conjunction with the company’s most recent annual consolidated financial statements, which have been prepared in accordance with IFRS as issued by the IASB. Interim results may not necessarily be indicative of results anticipated for the entire year.

New Accounting Standard

Financial statement presentation

The IASB amended IAS 1, “*Financial Statement Presentation*”. The amendments to IAS 1 require entities to separate items presented in other comprehensive income into two groups, based on whether or not they may be recycled to the statement of earnings in the future. Items that will not be reclassified will be presented separately from items that may be reclassified in the future, such as unrealized gains and losses on cash-flow hedges. The amendments are effective for annual periods beginning on or after July 1, 2012. The company adopted this new standard on September 1, 2012 and classified items of other comprehensive income accordingly.

3 Derivative Financial Instruments

The functional currency of the company is the Canadian dollar. The company is exposed to a currency risk as a result of its export sales of products manufactured in Canada, China and Finland, the majority of which are denominated in US dollars and euros. This risk is partially hedged by forward exchange contracts (US dollars) and certain operating expenses (US dollars and euros). Forward exchange contracts, which are designated as cash-flow hedging instruments, qualify for hedge accounting.

EXFO Inc.

Notes to Condensed Unaudited Interim Consolidated Financial Statements

(tabular amounts in thousands of US dollars, except share and per share data and as otherwise noted)

As at May 31, 2013, the company held contracts to sell US dollars for Canadian dollars at various forward rates, which are summarized as follows:

<u>Expiry dates</u>	<u>Contractual amounts</u>	<u>Weighted average contractual forward rates</u>
June 2013 to August 2013	\$ 5,700	1.0317
September 2013 to August 2014	18,600	1.0243
September 2014 to February 2015	6,600	1.0401
Total	<u>\$ 30,900</u>	<u>1.0290</u>

The carrying amount of forward exchange contracts is equal to fair value, which is based on the amount at which they could be settled based on estimated current market rates. The fair value of forward exchange contracts amounted to net gains of \$932,000 as at August 31, 2012 and net losses of \$416,000 as at May 31, 2013.

Based on the portfolio of forward exchange contracts as at May 31, 2013, the company estimates that the portion of the net unrealized losses on these contracts as of that date, which will be realized and reclassified from accumulated other comprehensive income to net earnings over the next 12 months, amounts to \$379,000.

As at May 31, 2013, forward exchange contracts in the amount of \$379,000 are presented as current liabilities in accounts payable and accrued liabilities in the balance sheet. These forward exchange contracts are not yet recorded within sales.

During the three months ended May 31, 2012 and 2013, the company recognized within its sales foreign exchange gains on forward exchange contracts of \$278,000 and \$44,000 respectively. During the nine months ended May 31, 2012 and 2013, the company recognized within its sales foreign exchange gains on forward exchange contracts of \$1,150,000 and \$399,000 respectively.

4 Share Capital

On November 7, 2012, the company announced that its Board of Directors approved the renewal of its share repurchase program, by way of a normal course issuer bid on the open market of up to 10% of the issued and outstanding subordinate voting shares, representing 2,072,721 subordinate voting shares at the prevailing market price. The company uses cash, short-term investments or future cash flow from operations to fund the repurchase of shares. The normal course issuer bid started on November 12, 2012, and will end on November 11, 2013, or on an earlier date if the company repurchases the maximum number of shares permitted under the bid. The program does not require that the company repurchases any specific number of shares, and it may be modified, suspended or terminated at any time and without prior notice. All shares repurchased under the bid are cancelled.

EXFO Inc.

Notes to Condensed Unaudited Interim Consolidated Financial Statements

(tabular amounts in thousands of US dollars, except share and per share data and as otherwise noted)

The following tables summarize changes in share capital for the nine months ended May 31, 2012 and 2013.

	Nine months ended May 31, 2012				
	Multiple voting shares		Subordinate voting shares		Total amount
	Number	Amount	Number	Amount	
Balance as at September 1, 2011	31,643,000	\$ 1	28,621,999	\$ 110,340	\$ 110,341
Redemption of restricted share units	-	-	184,167	-	-
Redemption of share capital	-	-	(63,146)	(244)	(244)
Reclassification of stock-based compensation costs to share capital upon exercise of stock awards	-	-	-	848	848
Balance as at November 30, 2011	31,643,000	1	28,743,020	110,944	110,945
Exercise of stock options	-	-	25,250	78	78
Redemption of restricted share units	-	-	127,632	-	-
Redemption of share capital	-	-	(41,651)	(160)	(160)
Reclassification of stock-based compensation costs to share capital upon exercise of stock awards	-	-	-	558	558
Balance as at February 29, 2012	31,643,000	1	28,854,251	111,420	111,421
Exercise of stock options	-	-	9,500	40	40
Redemption of restricted share units	-	-	70,052	-	-
Reclassification of stock-based compensation costs to share capital upon exercise of stock awards	-	-	-	429	429
Balance as at May 31, 2012	<u>31,643,000</u>	<u>\$ 1</u>	<u>28,933,803</u>	<u>\$ 111,889</u>	<u>\$ 111,890</u>

EXFO Inc.

Notes to Condensed Unaudited Interim Consolidated Financial Statements

(tabular amounts in thousands of US dollars, except share and per share data and as otherwise noted)

	Nine months ended May 31 2013				
	Multiple voting shares		Subordinate voting shares		Total amount
	Number	Amount	Number	Amount	
Balance as at September 1, 2012	31,643,000	\$ 1	28,710,891	\$ 110,964	\$ 110,965
Exercise of stock options	-	-	23,275	51	51
Redemption of restricted share units	-	-	127,949	-	-
Redemption of share capital	-	-	(205,123)	(793)	(793)
Reclassification of stock-based compensation costs to share capital upon exercise of stock awards	-	-	-	612	612
Balance as at November 30, 2012	31,643,000	1	28,656,992	110,834	110,835
Exercise of stock options	-	-	7,400	36	36
Redemption of restricted share units	-	-	141,725	-	-
Redemption of deferred share units	-	-	37,054	-	-
Redemption of share capital	-	-	(31,210)	(120)	(120)
Reclassification of stock-based compensation costs to share capital upon exercise of stock awards	-	-	-	649	649
Balance as at February 28, 2013	31,643,000	1	28,811,961	111,399	111,400
Redemption of restricted share units	-	-	16,752	-	-
Redemption of share capital	-	-	(252,974)	(979)	(979)
Reclassification of stock-based compensation costs to share capital upon exercise of stock awards	-	-	-	89	89
Balance as at May 31, 2013	<u>31,643,000</u>	<u>\$ 1</u>	<u>28,575,739</u>	<u>\$ 110,509</u>	<u>\$ 110,510</u>

5 Statements of Earnings

Net research and development expenses comprise the following:

	Three months ended May 31, 2013	Nine months ended May 31, 2013	Three months ended May 31, 2012	Nine months ended May 31, 2012
Gross research and development expenses	\$ 13,782	\$ 41,806	\$ 15,575	\$ 45,188
Research and development tax credits and grants	(2,209)	(6,671)	(2,402)	(7,225)
	<u>\$ 11,573</u>	<u>\$ 35,135</u>	<u>\$ 13,173</u>	<u>\$ 37,963</u>

EXFO Inc.

Notes to Condensed Unaudited Interim Consolidated Financial Statements

(tabular amounts in thousands of US dollars, except share and per share data and as otherwise noted)

Gross research and development expenses for the nine months ended May 31, 2013 include \$89,000 in restructuring charges (nil for all other periods).

Depreciation and amortization expenses by functional area are as follows:

	Three months ended May 31, 2013	Nine months ended May 31, 2013	Three months ended May 31, 2012	Nine months ended May 31, 2012
Cost of sales				
Depreciation of property, plant and equipment	\$ 398	\$ 1,265	\$ 482	\$ 1,534
Amortization of intangible assets	938	3,469	1,278	3,828
	<u>1,336</u>	<u>4,734</u>	<u>1,760</u>	<u>5,362</u>
Selling and administrative expenses				
Depreciation of property, plant and equipment	272	844	251	774
Amortization of intangible assets	417	1,291	450	1,377
	<u>689</u>	<u>2,135</u>	<u>701</u>	<u>2,151</u>
Net research and development expenses				
Depreciation of property, plant and equipment	803	2,473	787	2,326
Amortization of intangible assets	231	710	265	683
	<u>1,034</u>	<u>3,183</u>	<u>1,052</u>	<u>3,009</u>
	<u>\$ 3,059</u>	<u>\$ 10,052</u>	<u>\$ 3,513</u>	<u>\$ 10,522</u>
Depreciation of property, plant and equipment	\$ 1,473	\$ 4,582	\$ 1,520	\$ 4,634
Amortization of intangible assets	<u>1,586</u>	<u>5,470</u>	<u>1,993</u>	<u>5,888</u>
	<u>\$ 3,059</u>	<u>\$ 10,052</u>	<u>\$ 3,513</u>	<u>\$ 10,522</u>

Employee compensation comprises the following:

	Three months ended May 31, 2013	Nine months ended May 31, 2013	Three months ended May 31, 2012	Nine months ended May 31, 2012
Salaries and benefits	\$ 30,732	\$ 93,962	\$ 32,504	\$ 98,094
Stock-based compensation costs	415	1,331	370	1,433
Total employee compensation for the period	<u>\$ 31,147</u>	<u>\$ 95,293</u>	<u>\$ 32,874</u>	<u>\$ 99,527</u>

EXFO Inc.

Notes to Condensed Unaudited Interim Consolidated Financial Statements

(tabular amounts in thousands of US dollars, except share and per share data and as otherwise noted)

Stock-based compensation costs by functional area are as follows:

	Three months ended May 31, 2013	Nine months ended May 31, 2013	Three months ended May 31, 2012	Nine months ended May 31, 2012
Cost of sales	\$ 58	\$ 170	\$ 64	\$ 183
Selling and administrative expenses	252	875	183	888
Net research and development expenses	<u>105</u>	<u>286</u>	<u>123</u>	<u>362</u>
	<u>\$ 415</u>	<u>\$ 1,331</u>	<u>\$ 370</u>	<u>\$ 1,433</u>

6 Income taxes

For the three months and the nine months ended May 31, 2012 and 2013, the reconciliation of the income tax provision calculated using the combined Canadian federal and provincial statutory income tax rate with the income tax provision in the financial statements is as follows:

	Three months ended May 31, 2013	Nine months ended May 31, 2013	Three months ended May 31, 2012	Nine months ended May 31, 2012
Income tax provision at combined Canadian federal and provincial statutory tax rate (27% in 2013 and 28% in 2012)	\$ 11	\$ 448	\$ (891)	\$ 989
Increase (decrease) due to:				
Foreign income taxed at different rates	(45)	(323)	12	75
Non-taxable (income)/loss	(227)	(1,391)	746	1,229
Non-deductible expenses	184	607	158	840
Foreign exchange effect of translation of foreign operations	(223)	61	(1,246)	(2,680)
Recognition of previously unrecognized deferred income tax assets	–	–	–	(557)
Utilization of previously unrecognized deferred income tax assets	–	–	19	(7)
Unrecognized deferred income tax assets on temporary deductible differences and unused tax losses	1,226	3,920	1,618	3,305
Other	<u>(25)</u>	<u>799</u>	<u>124</u>	<u>218</u>
	<u>\$ 901</u>	<u>\$ 4,121</u>	<u>\$ 540</u>	<u>\$ 3,412</u>

EXFO Inc.

Notes to Condensed Unaudited Interim Consolidated Financial Statements

(tabular amounts in thousands of US dollars, except share and per share data and as otherwise noted)

The income tax provision consists of the following:

	Three months ended May 31, 2013	Nine months ended May 31, 2013	Three months ended May 31, 2012	Nine months ended May 31, 2012
Current	\$ 638	\$ 2,137	\$ 95	\$ 1,392
Deferred	263	1,984	445	2,020
	<u>\$ 901</u>	<u>\$ 4,121</u>	<u>\$ 540</u>	<u>\$ 3,412</u>

7 Earnings per Share

The following table summarizes the reconciliation of the basic weighted average number of shares outstanding and the diluted weighted average number of shares outstanding:

	Three months ended May 31, 2013	Nine months ended May 31, 2013	Three months ended May 31, 2012	Nine months ended May 31, 2012
Basic weighted average number of shares outstanding (000's)	60,377	60,386	60,537	60,440
Plus dilutive effect of (000's):				
Stock options	20	28	169	166
Restricted share units	619	640	887	972
Deferred share units	107	116	122	116
	<u>61,123</u>	<u>61,170</u>	<u>61,715</u>	<u>61,694</u>
Diluted weighted average number of shares outstanding (000's)				
Stock awards excluded from the calculation of diluted weighted average number of shares because their exercise price was greater than the average market price of the common shares (000's)	<u>9</u>	<u>71</u>	<u>-</u>	<u>64</u>

For the three months ended May 31, 2012 and 2013 and for the nine months ended May 31, 2013, the diluted amount per share was the same amount as the basic amount per share since the dilutive effect of stock options, restricted share units and deferred share units was not included in the calculation; otherwise, the effect would have been antidilutive. Accordingly, the diluted amount per share for these periods was calculated using the basic weighted average number of shares outstanding.